BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Milwaukee Water Works, Milwaukee County,
For Authority to Increase Water Rates — Docket No. 3720-WR-107

SURREBUTTAL TESTIMONY OF ERIC ROTHSTEIN
August 5, 2010

Q. Please state your name.

A. My name is Eric Paul Rothstein.

Q. Did you provide rebuttal testimony and supplemental rebuttal testimony on behalf of the intervening wholesale customers related to Milwaukee Water Works' (MWW) initial and revised rate application and the initial and revised cost of service study (COSS) prepared by Public Service Commission staff?

A. Yes.

Q. Have the intervening wholesale customers authorized you to provide surrebuttal testimony on their behalf?

A. Yes.

Q. What is the purpose of your testimony?

A. I will address the supplemental rebuttal testimony submitted by Carrie Lewis on behalf of Milwaukee Water Works.

Q. Please discuss your comments regarding Ms. Lewis's rebuttal testimony.

A. My comments relate primarily to Ms. Lewis' testimony responding to my (and others') expressed concerns regarding cash financing of MWW capital expenditures. First, I am concerned by her statement that "*[r]egarding comments relative to cash financing versus use* *of borrowed funds for capital projects, these are internal matters to be decided by MWW and the City of Milwaukee and not by rate case intervenors."* (R1.10, Lines 11-13).

This "none of your business" attitude, distressingly supported by Ms. Hubert's testimony on which I offered supplemental rebuttal testimony, is fundamentally at variance with imperatives for transparent management of a public utility and of the PSC's oversight responsibilities for protection of the public interest. It is the wholesale customers' business. It is so always but perhaps especially when considered in the context of MWW's request for such substantial water rate increases (generally over 25 percent) as we all confront harsh economic times.

Q. Do you disagree with Ms. Lewis' characterization of the merits of cash financing annual replacements?

A. No. As a general proposition, cash financing of annual reinvestments and use of debt for relatively "lumpy" major investments is a sound approach to capital financing which I have advocated myself in other contexts.

Q. What is problematic then about MWW's approach to capital financing in the context of this rate case?

A. Fundamental principles of utility financing, whether related to the determination of rates of return (which I addressed in my supplemental rebuttal testimony) or methods of capital financing should not be implemented myopically without exercise of due judgment. Financial planning requires insight and sensitivity to ratepayer impacts – the same type of sensitivity that has prompted the PSC to propose to "temper" rate adjustments to MWW's industrial users. If MWW is in a position to meet its funding needs without dramatic single-year rate increases, it should look for opportunities to do so. This is both MWW's responsibility as a public service provider, and the PSC's obligation.

In this situation, MWW's past capital financing practices (whether or not in keeping with the approach described in Ms. Lewis' testimony) has resulted in exceptionally limited debt, unlike its peer metropolitan or other major Wisconsin utilities (as evidenced by Exhibits 2.19 & 2.61). This affords MWW a unique opportunity to address its funding needs without imposing the large rate increases sought in this rate case, through strategic use of debt coupled with more modest rate adjustments. Similarly, the PSC has the opportunity to truly protect the public interest by recognizing that the atypical nature of MWW's capital structure (which by definition resulted from past practices that limited debt in favor of cash financing) now enables it to raise funds through more strategic use of debt rather than dramatic increases in allowed returns.

Q. Do you disagree with Ms. Lewis' assertion that "[c]ash financing for such replacements confers no generational inequity in that each year "pays for" one year's worth of replacement (R1.10, Lines 16-18)?

A. Again, no, but the failure to consider context in this regard speaks to formulaic rather than insightful financial planning and revenue requirement determination. If MWW recognizes generational equity concerns, it is hard to understand how single-year rate increases exceeding 25 percent could be deemed preferable to greater reliance on debt to mitigate rate increases, meet funding needs, and begin to balance MWW's capital structure. Dramatic single-year rate adjustments frustrate intergenerational equity.

Q. Why do you characterize MWW's financial planning and revenue requirement determination as formulaic?

A. In response to several points made over the course of this rate case, whether relating to application of cost escalation factors, the determination of allowed rates of returns, or the strategic use of debt, MWW and PSC staff have not modified their positions largely because adjustments would be at variance with historical practices. Capital structure is not considered because it is not standard practice in Wisconsin to do so, MWW's demonstrably atypical capital structure notwithstanding. Rather than look for opportunities to mitigate rate increases while meeting funding needs, MWW and PSC at worst have cynically manipulated standard practices that would place approximately $20 million at the City of Milwaukee's discretion (as discussed in my rebuttal testimony: SR2.99, Line 17-24) or, at best, have employed standard formulas and historical practices with a blind eye toward the unique attributes of MWW's financial position. Proposed rate increases in excess of 25 percent, especially for a utility that is not planning major capital spending and whose requested rate increase comes in the midst of severe economic decline, are exceptional.

Q. Wouldn't lower rate increases and increased indebtedness ultimately hurt MWW's financial position?

A. No. In fact, it may well improve MWW's financial position relative to a scenario whereby major rate increases are adopted by limiting further reductions in consumption that may be anticipated due to price elasticity of demand. In any event, strategic use of debt would simply better balance MWW's capital structure, and lower rate increases that still assure adequate revenues to meet a more suitable revenue requirement would help preserve MWW's financial strength. All parties may be served by a less formulaic, more strategic, and insightful approach to financial planning.

Q. Does this conclude your pre-filed surrebuttal testimony?

A. Yes.